BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
JUSTIN M. WOOL)

Appearances:

For Appellant: Justin M. Wool, in pro. per.

For Respondent: Richard C.Creeggan
Counsel

O P I N I O N

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Justin M. Wool against the proposed assessment of additional personal income tax in the amount of $88.75 for the year 1967.

The issue presented is whether appellant is entitled to all or any part of the nonbusiness bad debt deduction which he claimed for 1967.

During 1967 and in prior years appellant was employed by the City of Los Angeles as a water works engineer. In the course of his employment appellant became acquainted with James Stark, a geologist who worked under his supervision for about three years. In 1966 Stark quit his employment with the City of Los Angeles to take a job in Spain, but the job never materialized and Stark was unable to find other work, On several occasions appellant advanced money to Stark (a total of $245) in response to Stark's request for financial assistance,

In April 1967 Stark was arrested for a series of traffic violations; and through a bail bondsman he requested that appellant provide bail for him. Appellant did so on April 14, 1967, by securing bail bonds on behalf of Stark in amounts totaling $642.50. Thereafter Stark failed to appear in court and bail was forfeited. In accordance with the terms of the bail bond agreement he had signed, appellant paid the bonding agency $642.50, the amount of the forfeited bail, Stark left the United States shortly after April 1967 to take a job in Southeast Asia and appellant. has not heard from Stark since he left the country, His inquiries as to Stark's whereabouts proved fruitless.

In his income tax return for 1967 appellant deducted $887.50 as a nonbusiness bad debt loss. That deduction represented the $245 allegedly loaned to Stark plus the $642.50 paid when Stark forfeited bail. Respondent disallowed the entire deduction arid issued the proposed additional assessment here in issue. Respondent's denial of appellant's protest against that assessment gave rise to this appeal.

Section 17207, subdivision (d)(l)(B) of the Revenue and Taxation Code provides:

> Where any nonbusiness bad debt becomes worthless within the taxable year, the loss resulting therefrom shall be considered a loss from the sale or exchange, during the taxable year, of a capital asset held for not more than six months.

Respondent's regulations provide in part:

> Only a bona fide debt qualifies for purposes of Section 17207. A bona fide debt is a debt which arises from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money. (Cal. Admin. Code, tit. 18, reg. 17207(a), subd. (3).)

Appellant has the burden of proving that he is entitled to deduct the bad debt loss he has claimed. (W. B. Mayes, Jr., 21 T.C. 286.)

With regard to the cash allegedly loaned to Stark; respondent contends that appellant has failed to establish that any cash was actually transferred. We disagree. Although notations made by the taxpayer in his ledger constitute the only documentation of the cash advances to Stark, appellant's testimony at the hearing has convinced us that such advances were in fact made. Similar reliance was placed upon a taxpayer's testimony by the court in Redfield v. Eaton., 53 F.2d 693, another case involving a bad debt claim. The court there said:

> ...the only issue is one of fact, viz., whether the amount claimed by the plaintiff ... consisted of sums actually loaned, ...
>
> The plaintiff is a reputable lawyer.. .. That he is a lawyer, I find from his own testimony. That he is a reputable lawyer, I find from the impression that he gave, as a witness, of being candid, fair, accurate, and patient; also from the complete absence of evidence even tending to impeach his credibility,
>
> There was no evidence whatever to contradict the plaintiff's direct testimony that the several advances which he claimed as loans were actually made and never repaid, (53 F.2d at p. 694.)

There is a similar lack of evidence to impeach a very credible witness in the instant case.

With respect to the cash payments made to Stark, respondent also asserts that appellant has failed to establish that a debtor-creditor relationship ever arose between Stark and himself, as required by respondent's regulation quoted previously. Although the normal indicia of debt were not present here, it is within the prerogative of this board to find that a valid debtor-creditor relationship nevertheless existed. In Redfield v. Eaton; supra, the court stated:

> During the year 1926 to 1927 the plaintiff made numerous advances aggregating $1,433 to one Rita Allen, Until shortly before the period of these advances, Miss Allen, who was

> an actress, had had profitable employment on the stage. Shortly prior to these advances, her play terminated, and she has had no regular employment since. Here, again, there is nothing whatever in the evidence to indicate that the transaction was other than a loan. To be sure, the plaintiff testified that, when the loan was sought, Miss Allen had stated that she would repay him as soon as she got a job, (Emphasis added.) (Redfield v. Eaton, 53 F.2d 693, 694.)

The facts of the instant case are very similar to those in the Redfield decision. Appellant testified that Stark stated he would repay him as soon as he got a job. There is nothing before us to indicate that the transactions were anything but loans and, as we have stated previously, appellant's testimony to that effect was highly credible. We conclude, therefore, that the cash transfers took'place as alleged and that they were bona fide loans.

Respondent argues also that there was no debtor-creditor relationship between appellant and Stark with regard to the amounts paid on forfeiture of the bail bond. That payment was made by appellant in accordance with his agreement to indemnify the bonding agency in the event of Stark's failure to appear in court. In Howell v. Commissioner, 69 F.2d 447, cert. denied, 292 U.S. 654 [78 L. Ed. 1503], a case relied on by respondent, the court quoted with approval the following language from Brandt, Suretyship and Guarantee (3d ed.) vol. I. p. 20:

> The indemnitor is liable only to the indemnitee, and his assigns, and, unless he has stipulated for it, he has no remedy over against the party for whose benefit the contract was made. (69 F.2d at p. 451.)

Although appellant did not stipulate for a remedy against Stark in the event Stark should fail to appear in court, that fact is not a bar to appellant's claim in California. Section 2779 of the California Civil Code relating to indemnity agreements states:

> Where one, at the request of another, engages to answer in damages, whether liquidated or

> unliquidated, for any violation of duty on the part of the latter, he is entitled to be reimbursed in the same manner as a surety, for whatever he may pay.

Clearly, this section of the Civil Code, rather than the general rule stated in the Howell case, supra, is controlling here, When appellant became liable to reimburse the bonding agency for the loss it sustained' as a result of Stark's failure to appear in court, under section 2779 of the Civil Code Stark became indebted to appellant for the amount of that loss. Respondent 's assertion that no valid debtor-creditor relationship arose with respect to the amounts paid on forfeiture of the bail 'bond is therefore incorrect,

Respondent argues, finally, that none of the claimed deductions should be allowed because appellant has not shown them to have become worthless during 1967. We also disagree with this contention.

Stark left the country shortly after his failure to appear in court in April of 1967. The fact that appellant made no effort to collect the debt prior to Stark's departure is not conclusive . The 'applicable law is aptly summarized in 5 Mertens, Law of Federal Income Taxation, § 30.39:

> ...the requirement of a "reasonable" effort to collect may sometimes mean that under the circumstances it would be fruitless to make any effort at all, because of the hopeless insolvency of the debtor,. .. (Emphasis added.)

Authority for this statement is contained in Treasury Regulation 1.166-2(b) , which states:

> Where the surrounding circumstances indicate that a debt is worthless and uncollectible. and that legal action to enfore payment would in all probability not result in the satisfaction of execution on a judgment, a showing of these facts will be sufficient evidence of the worthlessness of the debt. ...

Prior to Stark's departure, he had been unemployed for a year. It is apparent that any attempt to collect the debt at that point would have been futile. The remaining question then is whether greater efforts should have been made to collect the debt subsequent to Stark's leaving the country.

Stark has not been heard from since he left the United States. He departed without contacting appellant and without leaving a forwarding address. Appellant made certain inquiries but was unable to ascertain Stark's whereabouts in Southeast Asia. Under these circumstances we do not believe it was necessary for appellant to have expended further effort in attempting to locate Stark in order for the debt to be deemed worthless in 1967.

In accordance with the views expressed herein, we find that appellant's claimed bad debt deduction in 1967 should be allowed in full.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

Appeal of Justin M. Wool

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Justin M. Wool against a proposed assessment of additional personal income tax in the amount of **$88.75 for** the year **1967, be** and the same is hereby reversed.

Done at Sacramento, California, this 10th day of April, 1972, by the State Board of Equalization.

John W. Lynch, Chairman

Richard Nevins, Member

Geo. R. Reilly, Member

Wm. M. Bennett, Member

_____, Member

ATTEST: W. W. Dunlop, Secretary